

J. STERN & CO.

The Value of Long-Term Investing

Investment Insight

METAVERSE, META AND US: AN OVERREACTION AND AN OPPORTUNITY

"Focus on long-term impact emphasises long-term thinking and encourages us to extend the timeline for the impact we have, rather than optimising for near-term wins. We should take on the challenges that will be the most impactful, even if the full results won't be seen for years."

Mark Zuckerberg

Just two weeks after Meta's share price tumbled amid warnings of revenue shortfalls, its founder and CEO, Mark Zuckerberg shared [a blog post](#). The post wasn't about earnings, user numbers or announcing a new project. It was on company values. Zuckerberg somewhat modestly wrote that the company "had transformed a lot" since the values were last penned in 2007 and that they needed to be updated to reflect Meta's next chapter. It was poignant to us that the second value on his list of six was "Focus on Long-Term Impact." After all, one of our abiding principles is to focus on quality companies over the long term.



Source: Meta

We are a significant holder of Meta in our World Starts Global Equity Portfolio, and we continue to be so despite the revenue shortfalls. We believe the market overreacted, with many investors opting to take a short-term view of events. We also strongly suspect that some of Meta's warnings of the increased competition from the likes of TikTok were deliberately directed at the ongoing antitrust case. And we said as much publicly.

"We suspect that some of its warnings were a deliberate direction to the ongoing antitrust case"

In the immediate aftermath of its 2021 full-year results announcement on 2 February, our strong views were picked up, first by [Financial Times columnist Robert Armstrong](#) and second by [Barron's](#). In this insight, we take a closer look at those results announced in early February and provide our view on why, unlike many investors, we are focusing on Meta's long-term value.

META: AN OVERREACTION AND AN OPPORTUNITY

Shares in Meta, the owner of Facebook, have fallen by more than 45% since its September high. To recap, on 2 February, the company warned that first-quarter revenues would fall short of expectations in light of tougher competition from rivals such as TikTok. Shares tumbled 27% on the news, their biggest ever daily fall. The shares have remained subdued and had fallen to USD 207, a drop of 36% since it aired its results.

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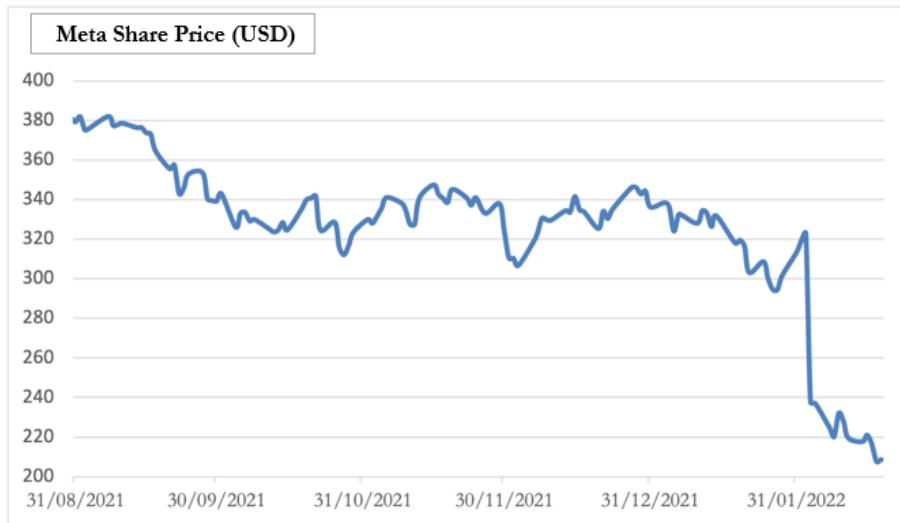
A snapshot of what Meta said when it announced its 2021 results to the market earlier this month:

Meta on impressions:

"We expect continued headwinds from both increased competition for people's time and a shift of engagement within our apps towards video surfaces like Reels [its short video channel] which monetise at lower rates than Feed [its updating news feed] and Stories [its visual content channel]."

Meta on pricing:

"We expect growth to be negatively impacted by a few factors. First, we will lap a period in which Apple's iOS changes were not in effect and we anticipate modestly increasing ad targeting and measurement headwinds from platform and regulatory changes. Second, we will lap a period of strong demand in the prior year and we're hearing from advertisers that macroeconomic challenges like cost inflation and supply chain disruptions are impacting advertiser budgets. Finally, based on current exchange rates, we expect foreign currency to be a headwind to year-over-year growth."



CEO Mark Zuckerberg:

"There are two things that I want to call out that are impacting our business. The first is competition. People have a lot of choices for how they want to spend their time. Apps like TikTok are growing very quickly. This is why our focus on Reels is so important over the long term. The second area, which is related to this, is that we are in the middle of a transition on our own service towards short-form videos, like Reels. As a result of both competition and the shift to short-term short-form video, as well as our focus on serving young adults, we're going to continue to see some pressure on impression growth in the near term."

OUR VIEW: META IS EXTREMELY CHEAP GIVEN ITS SCALE

We strongly believe that the recent share price drop in Meta is a great opportunity for long-term investors to buy a great franchise that has sold off on very short-term considerations.

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As one of our favourite quotes from Warren Buffett goes, whether it's stocks or socks, we like buying quality merchandise when it is marked down. Buffett purchased Apple, now Berkshire Hathaway's single largest position, at the right time, when markets had lost confidence in the business and its prospects. We would not be surprised to see him, or perhaps more likely one of his two portfolio managers Ted Weschler or Todd Combs take a stake.

The platform has lots of levers across all three of its major applications to be able to continue to deliver for its users. The slowdown in active users is primarily because of the younger generation, who are more inclined to short-video content, but the company's 3.6 billion monthly active users represent a very significant share of people with internet access. It is also not the first time that it has faced existential threats before, including whether it would be able to reach users via mobile and it could monetise different services. It has a track record of being able to figure those things out.

Meta's market cap is now below the USD 600 billion threshold for antitrust scrutiny

The constant emphasis placed by Meta during its earnings call highlighting the increased competition from TikTok versus its Reels channel and the negative impact Apple iOS privacy changes have had on advertising, should be seen in the context of the antitrust scrutiny. The name-checks came less than a month after a US judge ruled that the US Federal Trade Commission can proceed with its revised lawsuit to force the demerger of Meta's Instagram and WhatsApp.

We believe it may have overemphasised the extent deliberately, exposing to the antitrust authorities the truly dominant competition in the sector. Make of it what you will, but Meta's market cap has now shrunk to below the key USD 600 billion threshold for antitrust legislation and scrutiny in the bills currently going through the US Congress.



Source: Pixabay

The jury, in our view, is still out on the impact of TikTok on Reels and, particularly Instagram. Reels is Meta's version of bringing short form, entertaining video experiences and tools to users, and Meta's priority is to make it more engaging than Feed or Stories. It is important to realise that Instagram is already a fully-fledged social media channel and shop window for the world with many ways of monetizing its platform, both for its content providers and for Meta itself. Instagram provides a prime example of Mark Zuckerberg's innovation and vision. What started as effectively a photo-sharing app, has evolved into a social media e-commerce platform that is more powerful than Facebook and may well be the primary driver for Meta going forward.

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Impact of Apple iOS 15 to fade in 2022

Meta said that last year's introduced changes to its iOS 14 and 15 operating systems that allows iPhone users to opt-out of sharing their Identifier for Advertisers (IDFA) would impact ad sales by [would impact its sales by USD 10 billion this year](#). The IDFA allows advertisers to track users' data so it can deliver customised or more targeted advertising. However, reports suggest that nearly two-thirds of iPhone users are opting out of sharing their IDFA.

However, we believe that the long-term impact will be manageable and that the company will find its own ways of being able to get data that its users want to share. Meta does not expect that the new iOS 15 that was released last September will still be a headwind as the year progresses. It also mentioned that it is close to finalising the development of an advanced AI and Big Data computer machine. This will enable Meta to utilise algorithms and data points to generate advertising insights for a user base of around three billion.

Near misses mask Meta's strong fundamentals

The stock at \$208 a share yesterday is extremely cheap, given the scale and sustainability of the business. Despite a slowdown in user growth and higher costs that missed market expectations, Meta's results delivered a strong fundamental performance in revenues and profitability.

By their very nature, markets react to short-term misses on measures. Meta generated USD 32 billion in advertising revenues in the fourth quarter, which annualised, is more than USD 120 billion. That is an extraordinary figure. We are comfortable that the business has decided to reinvest in line with Zuckerberg's statement about looking out to the long-term. This reinvestment explains the operating margin and the EPS misses, which are still in the high 30s. The other misses, on the daily and monthly active users, are marginal but the overall numbers have continued to grow and demonstrate ongoing engagement.

Fourth-quarter earnings

Meta	Actual	Estimate	Inline or miss
Total revenue	USD 33.6 billion	USD 33.4 billion	Inline
Ad revenue	USD 32.6 billion	USD 32.5 billion	Inline
Operating margin	37%	38.5%	Miss
GAAP EPS	USD 3.67	USD 3.84	Miss
Daily active users	1.93 billion	1.946 billion	Miss
Monthly active users	2.91 billion	2.949 billion	Miss

We understand market concerns that Meta may have put too much on its plate with higher costs linked to seven priority investment areas, one of which is the metaverse. However, we take positives from the company committing to becoming a leader in this new sphere and expect that these investments will generate significant returns.

Long-term vision and value

The world's biggest digital platforms have important qualities in common: They are led by visionary people who have built transformative trillion-dollar businesses by embracing

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disruption and opportunity – and by making long-term investments that are measured in decades, not quarters or years.

It is true for Steve Jobs who transformed the way we use devices, for Bill Gates who transformed the way we use computers and for Jeff Bezos who transformed the way that we use e-commerce. It is also true for Mark Zuckerberg who transformed the way that we use social media.

Zuckerberg's original ideas go back two decades. However, Meta has evolved since it was launched as Facebook in 2004 by innovating, diversifying and amplifying. From promising but early acquisitions, it has created multi-billion dollar businesses in WhatsApp and Instagram. Today, the company is at a time of transition, of maturity of its “blue app” Facebook, but also of great opportunity to continue to innovate and to engage with its users through the metaverse and other means. Although Meta has challenges to address in the short term, its track record and long-term focus suggest they are challenges that it will overcome.

The market may have taken fright at the results, but we remain resolute in our long-term stance on Meta. In our view, it was the *way* the results were presented rather than the actual numbers it revealed that was most telling. The strategic element of how Zuckerberg chose to communicate its latest earnings may have impacted the short-term share price reaction and provided an opportunity. Its business fundamentals, the realization of its long-term vision and the growth and profitability of its business will drive its results and its share price.

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